Macro Insights Weekly
ASEAN-6 - Go with the (portfolio) flow

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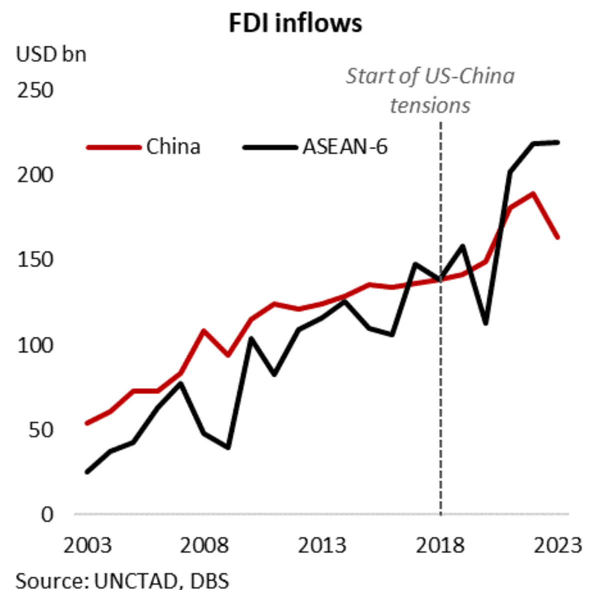
- *ASEAN's portfolio flows have been a mixed bag compared to positive FDI flows.*
- *Equity markets are in red year-to-date, diverging from better-performing Northeast Asian markets and India.*
- *Catalysts such as portfolio rebalancing and a return to domestic growth themes may spur inflows.*
- *Foreign interest in bond markets varies, driven by rate differentials and macro stability buffers.*
- *The pace of ASEAN's bond inflows in 2H hinges on the Fed's pivot and stable regional rates.*

Chart of the Week: ASEAN and China FDI inflows

FDI inflows into the ASEAN-6 region have exceeded those into China in the past three years. In 2023, the region received resilient inflows of almost USD220bn, accounting for 16.5% of global FDI inflows. These were comparable to those in 2022. Investor interest has been buoyed by efforts to diversify supply chains by adopting a 'China+1' strategy. In contrast, China's FDI inflows fell in 2023, amid investor concerns over its long-term challenges and growth prospects.



Source: UNCTAD, DBS

Commentary: Portfolio flows hinge on global cues

Supply chain shifts through the adoption of the 'China+1' strategy have unequivocally benefited the ASEAN region. While regional economies have long attracted foreign direct investment inflows, two push factors have accelerated that move since 2017: de-risking since the onset of US-China tensions and supply chain reconfigurations brought about by the pandemic.

Portfolio flows, on the other hand, have been a mixed bag. Equity markets have witnessed net outflows on a year-to-date (YTD) basis in the five countries in ASEAN-6 – Indonesia, Malaysia, Philippines, Thailand, and Vietnam – for which regular data is reported. This contrasts with strong net inflows into South Korea, Taiwan, Japan, and India. The direction of flows is also mirrored in the key indices' performance, with Taiwan's Taiex up more than 30% YTD (TSMC at a record high), alongside strong gains in South Korea's Kospi, and Japan's Nikkei, all of which are topping the charts in Asia. This is followed by India's equity indices up 11.0-12.5% on a YTD basis, establishing fresh record highs. ASEAN markets lag this exuberance. Notably, few of the better-faring Asian markets have also seen an upsurge in retail participation, which has lent resiliency to the price action.

One reason for this gulf between markets lies in the higher weightage of tech and AI-related stocks in the Northeast Asian bourses, vis-à-vis ASEAN indices. The latter is dominated by financials, commercial services, industrial counters, and consumer staples. This wedge is also pronounced in the US stock markets, where the tech-heavy indices have outpaced the other economy-related/ sectoral counters by a significant margin.

The other hurdle for dollar investors is weak Asian currencies, which cut into returns on local shares i.e., amounts to translation risks. For instance, Thailand has been one of the underperformers in the region, registering negative returns on local currency and USD-adjusted basis. Malaysia, on the other hand, has notched strong gains on MYR and USD basis, as investors are encouraged by the improving investment prospects.

Indian equities stand out on most counts, with the equity markets amid a broad-based rally, attracting a strong IPO pipeline, backed by a growing retail presence (record number of systematic investment plans) and registering gains on the dollar as well as local currency terms on a YTD basis (helped by a relatively stable INR amidst low implied volatility).

Encouragingly, foreigners have turned net buyers of stocks in July, as Indonesia, Malaysia, and the Philippines present attractive entry levels. Besides portfolio rebalancing, a return in focus towards domestic growth themes or a preference for defensive stocks are likely to boost broader returns in the regional markets.

The direction of foreign interest in the region's bond markets is more varied, driven by rate differentials and macro stability buffers, especially fiscal health and currency volatility. Malaysia and the Philippines have received net inflows on a YTD basis, while Indonesia and Thailand have faced outflows.

In Indonesia, besides narrow rate differentials vs the US, concern about a departure from a longstanding policy of fiscal conservatism has

impacted the view on the currency and bonds. Markets are positioned for the risk of lower fiscal prudence by the incoming administration. Thailand faces similar headwinds, as political uncertainty and proposed short-term stimulus have increased the risk of higher fiscal deficits and debt burden.

Investors are likely to eye two developments in 2H24. First, signs of a US Fed rate pivot and lower US yields are likely to shift the focus back to the regional asset markets. Second, a delay in monetary easing to mimic the US Fed will also be supportive of rate differentials, aiding inflows. We expect most regional central banks to keep rates on hold in 2H24 to preserve currency stability and provide attractive premiums.

Radhika Rao & Chua Han Teng

FX: Fed cuts to eclipse Trump Trade

The DXY Index depreciated 1.7% in the first fortnight of July to 104.09, back to early June lows. The greenback is under pressure from the futures market, increasing the probability that the Fed will start lowering rates in September to 94.5% vs. 56.5% at the last FOMC meeting on June 12. **Fed officials have become more confident about US inflation resuming its decline after a sticky first quarter.** CPI inflation fell a third month and posted its first negative month-on-month reading since May 2020. The Fed's favourite inflation gauges, the PCE deflators, should mirror the softer CPI readings. PCE inflation fell to 2.6% YoY in May, hitting the Fed's forecast for 4Q24. Core inflation was more impressive by declining to 2.6%, below the Fed's 2.8% forecast.

Today, Fed Chair Jerome Powell will focus on "balanced risks" during his interview at the Economic Club of Washington DC. **Powell will likely be less concerned about reducing rates too soon without reigniting inflation while acknowledging that lowering them too late could lose the economic expansion.** The US unemployment rate extended its rise to 4.1% in June after hitting 4% in May, the Fed's forecast for 4Q24. During his semi-annual testimonies last week, Powell told US lawmakers that the Fed could respond if the US labour market weakened unexpectedly in a material way.

Assuming the US inflation and jobs data keep moving as they have, the Fed could become to be less neutral at the FOMC meeting on July 30-31 and affirm a bias to lower rates in September at the Kansas City Fed's Jackson Hole Symposium on August 22-24. We maintain our view that the Fed should start lowering rates every quarter from 3Q24 through 4Q25.

Meanwhile, the **USD is clawing back some of its losses on the "Trump Trade"** after the failed assassination attempt on the Republican presidential candidate, Donald Trump. With President Joe Biden losing support from Democrats for his re-election bid, polls are skewed towards Trump at the US Presidential elections on November 5. **However, we are sceptical about a replay of the USD's rally into Trump's victory in the 2016 elections.** Today, the Fed is looking to lower rates after a hiking cycle and not at starting a two-year hiking cycle in December 2016. The fiscal situation has become unsustainable after persistent budget deficits during the Trump and Biden terms. The Congressional Budget Office projected the federal debt held by the public exceeding 100% of GDP in 2025 from 75% in 2015. DXY plunged almost 10% in 2017 during the first year of Trump's presidency from political uncertainties in the US amid more economic optimism in Europe and emerging markets.

We have lifted our end-2024 target for USD/CNY to 7.21 from 7.12. The People's Bank of China raised the daily fixing from 7.0950 at the end of 1Q24 to 7.1315 last Friday. The central bank is gradually shifting monetary policy from quantitative targets towards interest rates. The PBOC is studying how to carry out government bond trading in the secondary market with the finance ministry without being seen as adopting quantitative easing. Year-to-date, the 10Y bond yield declined by 30 bps in China vs. a 30 bps increase in the US, while the SPX 500 rallied 17.7% vs. a slight 1.2% gain in the CSI 300 Index. However, we expect the USD to decline against the CNY when the Fed cut cycle begins.

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